BUILDING AND LOAN ASSOCIATIONS THE SOLUTION OF THE RURAL CREDIT PROBLEM

By Professor WILBUR O. HEDRICK
MICHIGAN AGRICULTURAL COLLEGE

THE enjoyment of his personal credit has become a matter of larger concern to the thrifty bread winner during recent years than was formerly true. The limiting of liability for collective indebtedness and the abolishment of prison sentences for debt, which took place simultaneously in civilized countries a half century ago, did much to relieve the odium and danger which prior to this time had attended using one's credit and made borrowing—especially for productive purposes—not only permissible, but actually commendable.

The opening of this newly approved field of opportunity was at once taken advantage of by many new credit-handling organizations. Banks increased in numbers wonderfully and, in addition to banks, trust companies, savings banks, building and loan associations, investment companies and many other credit agencies of lesser note came into existence for the handling of certain special supplies of or demands for this great resource. Credit is, indeed, in all its aspects essentially of the same nature—the transfer of something of a valuable character to another without an immediate equivalent in return—and it has as many varieties as there are credit agencies, or, literally, as there are uses or supplies. Thus there is bank credit, building and loan credit, merchants' credit, and, more technically, short or long credit, secured and unsecured credit and many others reflecting the effects of multitudes of practical influences.

The farmer's need for credit is of a highly specialized sort. The canvass of the credit needs of the farmer made by the Department of Agriculture in 1912–13 shows that it is customarily a period of from four months to four years which measures the length of the loan which farmers desire to make. The credit loans made by farmers for the shorter period is in the nature of advances upon crops for the growing of which the farmer is naturally short of means at seed time, but is opulent at time of marketing, for carrying cattle through feeding time and, in short, for defraying current expenses. The longer period of credit loans is for buying land, building silos or for making other permanent improvements. It will be seen at once that the farmer's use of credit is for investment purposes and that his patronage of customary banking agencies helps but little the store of liquid assets which are indispensable to the successfulness of the ordinary commercial banks.

The ordinary commercial banks are indeed limited by many handicaps in their dealings with farmers. In addition to purveying a variety of credit, which at its best is absolutely useless to farmers, commercial banks have an expensiveness of management which increases materially the cost of borrowing to the farmer. The up-to-date consumer and producer of commodities everywhere believes firmly that a cause of the current high prices of commodities may be found in the existence of too much interference, too much friction, too many hindrances (as a result of our middleman system) in the passage of products from their place of origin to their place of consumption. May not a similar explanation account for the high charges which bankers make for the transfer of credit from the hands of depositors to the hand of borrowers? Expensive legal regulations, for example, restrict the banker in all directions. He is legislated upon with regard to inspection, to his reserves, to his ownership liabilities, his interest charges, his mortgage foreclosures, limitations of loans to borrowers, creditability of farm lands to one half value, form of bank issues, character of securities, etc. An examination of these typical regulations will show that most of them are framed in the interests of the depositors and have for their purpose the worthy object of insuring a bank's business safety. But are such safeguards necessary for credit agencies which deal only with farmers, and should the countryman pay the increased price for his loans caused by the regulations which are intended as safeguards against the more speculative business of the city?

So small a point even as that of variation in business habits on the part of farmers and bankers tends constantly toward the estrangement of these two classes each from the other. The farmer is proverbially lax in keeping appointments with a bank, but the bank proverbially is adjusted to methods of punctuality. Most farmers also wish the cash itself when borrowings are made from banks, instead of merely credit; on the other hand, bankers wish to loan credit and are loath indeed to allow cash to be taken from their possession. Little frictions of this sort, however, are not, in fact, irremediable, but the serious one of applying an agency adjusted to the demands of one occupation to performing a service for another and very different occupation does not seem easily capable of reconciliation.

The penitential self-searching which our nation gave itself a few years ago in carrying out the far-famed conservation movement resulted in a few things which promise to be more lasting than the discovery of agricultural credit. It is true that farm credit had not been unknown among our many economic resources prior to this time, but it required the stress of a national hunt seeking our most remote and minutest assets for conservation purposes to bring out this great utility and reveal its actual proportions and real importance. It is with the con-

servation movement then—conservation of our human as well as our natural resources—with its problems of reforestation, of slum recovery, of desert reclamation and white slavery that the question of rural credit comes up.

A contributory reason for the appearance of this question among us, furthermore, is found in the enormous growth in value attained by farm property in recent years. The census of 1910 shows that during the preceding decade farm land had increased in value more than 100 per cent., and that the annual agricultural output had grown from about four billions in 1899 to nine billions in 1910. It has now grown to many more billions than this, with corresponding increases in the value of land. The existence of so much negotiable wealth in any occupation must necessarily add immensely to the credit possibilities within that occupation over what had previously prevailed.

The handling of the credit which arises from this stupendous amount of wealth has rested mainly in the past with the ordinary commercial banks of the country. The growth in numbers and profitableness of these institutions—national, state and private—within the last decade and a half is looked upon everywhere as phenomenal and little doubt can be felt by any one that much of the prosperity which this banking pursuit has enjoyed is derived from the increasing prosperity of farmers. The commercial banks indeed have been wide awake to the possibilities of this new field of credit resource—especially from the standpoint of its furnishing a new source of credit supply or deposits. In addition to the usual advertising, for example, which banks of all sorts put out to secure customers, bankers' organizations, both state and national, have in recent years appointed active committees upon agriculture to look after this interest in connection with their occupation, one or two agricultural banking periodicals have come into existence, local bankers have been among the chief promoters of the county farm agent undertaking in our various counties and banks everywhere vie with the railroads in the promotion of agriculture in the different neighborhoods through financing dairy-yield rivalries or alfalfa- and corn-growing contests.

The outcome of greatest note from the abnormal credit conditions described above has been the enlistment of the national government in the cause of improved rural credit. The Washington authorities have actively sympathized with the improvement of farm credit facilities for at least two reasons. First, because it was thought that better credit to the farmers would better agricultural production and lower the cost of living; and, second, because an improved supply of long-time farm credit might stop the spread of tenancy which is now so menacing, through allowing more farmers capital wherewith to buy farms. A gathering of the House of Governors considered the proper steps to be taken upon this matter in 1912, and two great commissions were sent abroad

by the combined state and national governments a year later to study the problem in Europe. The report to Congress of one of these commissions embodied a bill which provided for land-mortgage banks chartered by the federal government which should be similar in character to those of European countries. This bill was actively considered by congressional committees during the entire year following a promise from the administration in connection with the enactment of the federal reserve law, that rural credit legislation should be immediately taken up for adoption under a separate bill. The president's annual message also strongly urged the adoption of rural credit relief. In spite of this promise and this message, the rural credit bill was finally shelved so far as the first Wilson congress was concerned, by a congressional caucus late in the session. The Congress which ended last March appointed finally a commission, which should hold recess "hearings" and bring in a satisfactory rural credit bill at the commencement of the present session.

The improved rural-credit plan toward which the government is tending with its approval is the land-mortgage bank scheme, so conspicuously successful in European countries during recent years, and taking form in Congress through the provisions of the Bulkly-Hollis bill. These banks are at present with us invariably the product of state legislation. They are subject to ownership by private corporations and, in some instances, use state facilities in carrying on their work. Although varying slightly in details in different localities, their methods of operation are universally similar and may be quickly described as endeavors to transform a farm's creditableness into a shape available for purchase by the investing public. This is accomplished uniformly in the same fashion, namely, by taking mortgages upon farms (the loans secured by these mortgages being in the interests of the borrower of the installment payment type) and upon the aggregate security of these mortgages selling bonds in such denominations as best suits the investing customer. The bonds run for a limited number of years and bear such a rate of interest as will enable the bank to make a profit between the interest receipts received upon its mortgages and the interest rate paid upon its bonds. These banks market their own bonds without the aid of a central institution and make mortgage loans over a limited territory.

Let us now turn to an examination of the fitness of these land mortgage banks in comparison with their rivals, the building and loan associations, to undertake successfully the handling of the rural credit situation. Building and loan associations were first organized in Philadelphia in 1831 by working men, and, as their name implies, they are credit-furnishing societies rather than credit accumulators like the savings banks. They are cooperative in form of organization, and their funds are obtained from loaners who are seeking long-time investments. They have already become so thoroughly established among our credit

handling agencies that most states have provided special laws for the incorporations of these societies and special methods for their supervision. Their growth has been phenomenal, the hand-book for the national gathering of these associations for 1913 showing an aggregate of more than six thousand societies with a sum exceeding a billion of dollars equalling their assets.

Both kinds of institutions we notice at the first glance are similar to each other in the important fact that their loans are repayable upon the installment plan—the land-mortgage banks using as an amortization scheme of arranging its installments while the building and loan companies employ the scheme of the sinking fund. The land mortgage banks, indeed, have a decided superiority over the loan companies in this matter of installments through the greater simplicity of the contracts which they offer to the borrowers. The extreme simplicity of the amortized installment arrangement which the land banks use may be quickly grasped by any one accustomed to paying debts, but the building and loan method of using stock as a means to offset a loan is novel, and its merits are only seen after much explanation. Indeed, it is authoritatively claimed that a governmental subsidy to building and loan associations could not be used to better purpose than in conducting an educational campaign by which people generally would come to understand these institutions.

The loan societies and the land banks have both at bottom identical purposes, since both are largely agencies for the collection of money for certain definite uses, but the loan associations do this by selling stocks, the land banks by the sale of bonds. Unquestionably, the well-known characteristics of each of these two kinds of securities act in a similar fashion when applied to loan companies and land banks as when applied to any other type of corporation. The purchaser of a bond looks primarily to the security of his investment. He wants an assured interest income together with certainty of redemption of his bond at maturity. The buyer of a stock, however, is willing to assume a risk in the hope of possible gain. He takes things on a contingent basis. He wishes to participate in the business itself and the building and loan societies may properly benefit from this fact that its members, being stockholders, may be expected to give their common institution its much needed asset of publicity, while this end is attained by the land banks only through the use of the customary advertising.

It is sometimes assumed that mortgage banks have an advantage over building and loan companies because bonds have a more universal market than have stocks—the bond buyer, it is claimed, being only slightly interested in the management of his company, may live anywhere, while the stockholder seeking the highest contingent returns must live in the neighborhood of his property where he may have over-

sight of the administration. Substantial devices exist, however, whereby the loan society may reach out for a wider market than would naturally seem possible—such, for instance, as the sale of paid-up stock or the change from a local into a national society. The marketing successes of the two sorts of companies may be further characterized by the observation that building and loan companies have already made their reputation with the public in this country and the governmental administrative machinery for their control has become well established. On the other hand, the land banks, to a large extent, are still novelties unknown upon the markets and must yet commend themselves to the public in order to sell their bonds.

In the vital matter of expensiveness of loans, building and loan charges for a long-time debt are doubtless lower than are those of the land bank companies because, while the interest charges upon loans will be the same in both cases, the building and loan system of using a sinking fund with which to cancel a principal gives the borrower the earnings of this fund and may therefore reduce his total indebtedness.

Some problems there are in which both sorts of institutions are concerned, and in the interests of a full presentation of our problem these common grounds also must be described. Both, for example, are similarly interested in the question of freedom from taxation. It seems a slight subsidy indeed to request at the hands of government that institutions having such laudable purposes as the furnishing of homes or farms to people should be exempted from the usual public burdens. This consideration indeed receives added force when we remember that homes and farms are the very kinds of property which governments enjoy taxing to the uttermost, so that the eventual issue from the work of credit companies is to increase the field of revenue receipts for governments.

The problem of standardization of type for both the loan companies and the land banks is one which presents many perplexities. No other merit is more frequently assigned to the federal bill for chartering land banks than the one that it gives a federal charter whereby all of these banks will be uniform throughout the land. This uniformity will of itself, it is claimed, give standing and reputation to the concerns involved, since application merely of the same name, not to mention other opportunities, to the same institution everywhere will develop public familiarity which will be invaluable for security marketing purposes. On the other hand, the proposition which is frequently made to have the bond selling for these banks performed by a single institution within each state is very vigorously condemned, since it is asserted this will allow no flexibility between different parts of the state having different degrees of economic development as to interest rates, time terms, commissions, etc. Evidently this problem of flexibility or uniformity is

one of much delicacy. The loan societies have tended always toward flexibility, and they have doubtless benefited from this adaptiveness. We find no uniformity of name, for example, among these societies so that the same type may be designated by a different title in every different locality. In New England, as a case in hand, they are Mutual Savings banks, here in the Middle West we name them Savings and Loan societies or Building and Loan societies indifferently; their business processes vary incalculably, seventy methods of premium determinations are in vogue and almost half as many for distributing profits. It is quite within the range of doubt that so much variety is necessary and it would seem clear that some of the benefits claimed from uniformity by the banks would apply to loan societies also should they conform more closely to a single type.

The suitability of building and loan societies for furnishing rural credit is indeed no longer a mere academic question. They have already entered this field, particularly in the state of Ohio, where a recent report from the secretary of state for the commonwealth shows that more than fifteen millions of dollars are loaned by these societies for the purchasing of farms. It has been the business of these associations everywhere from the start to find creditability in the laboring man and to allow the laboring man the enjoyment of his creditability. They will be equally successful in discovering the credit resources of the farmer. Credit is proverbially shy and credit relations which are to endure for a half generation or more will not be entered into as readily with some new creation of law as with some association which has already solved the practical problems involved in legal, political and business adjustment. Furthermore, since loan associations are invariably cooperative in character they will form still another opportunity for this species of associative activity which is now regarded everywhere as indispensable to the farmer's development.

Apparently it is regarded as imperative that Congress shall provide some source of credit to the agriculturist during its present session. Ought not our lawmakers to throw such support as they are prepared to give for the improvement of rural credits in the direction of building and loan associations rather than toward mortgage banks? As we have tried to show, loan societies are strictly American in their origin, are specialized to long-time easy payment loans, have become thoroughly adjusted to our legal system and business methods, are reputable and have shown practically their successfulness in performing the work at hand.